

STATE OF MICHIGAN

IN THE SUPREME COURT

**Appeal from the Court of Appeals
E. Thomas Fitzgerald, Presiding Judge**

**CATALINA MARKETING SALES
CORPORATION,
Petitioner-Appellant,**

V

**DEPARTMENT OF TREASURY,
Respondent-Appellee.**

**SC: 121673
COA: 221811
MTT: 231397**

**CATALINA MARKETING
CORPORATION,
Petitioner-Appellant,**

V

**DEPARTMENT OF TREASURY,
Respondent-Appellee.**

**SC: 121674
COA: 221890
MTT: 231398**

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PETITIONERS-APPELLANTS' BRIEF ON APPEAL

Oral Argument Requested

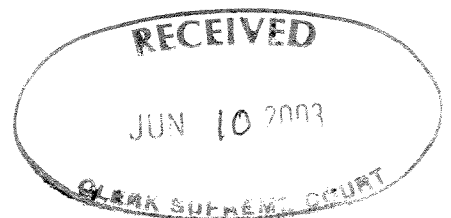


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STATEMENT OF BASIS OF JURISDICTION

This Court has jurisdiction over this case under MCR 7.301(A), 7.302(F)(1), and MCL 600.215. In a final Order issued August 9, 1999, the Michigan Tax Tribunal awarded summary disposition in favor of the Department of Treasury. Catalina Marketing Corporation and Catalina Marketing Sales Corporation appealed to the Michigan Court of Appeals, which affirmed in an Opinion issued March 5, 2002. Catalina Marketing Corporation and Catalina Marketing Sales Corporation filed a motion for rehearing on March 26, 2002, which the Court of Appeals denied on May 10, 2002.

Catalina Marketing Corporation and Catalina Marketing Sales Corporation timely filed an Application for Leave to Appeal with this Court, pursuant to MCR 7.302 on May 31, 2002, which this Court granted on March 25, 2003.

QUESTION PRESENTED FOR REVIEW

DO SALES OF PETITIONERS-APPELLANTS' "CHECKOUT COUPON™ PROGRAM" CONSTITUTE "SALES AT RETAIL" UNDER MCL 205.52?

Petitioners-Appellants say No.

Respondent-Appellee says Yes.

Court of Appeals said Yes.

The Michigan Tax Tribunal said Yes.

STATEMENT OF FACTS

A. The Taxpayers and Their Business Activities.

This case arises out of the Michigan Department of Treasury's (the "Department") sales and use tax audit of Petitioners-Appellants Catalina Marketing Corporation (CMC) and one of its affiliates, Catalina Marketing Sales Corporation (CMSC) (hereinafter collectively referred to as "Catalina" unless referenced independently) for the combined tax periods January 1, 1991 through June 30, 1993 (the "years in issue"). The audit concerns the taxability of Catalina's Checkout Coupon™ Program activities in Michigan.¹ CMC and CMSC are Delaware corporations each with their respective principal place of business in St. Petersburg, Florida. SOF ¶1, ¶2, Appendix p 112a.² CMSC is a wholly-owned subsidiary of CMC, and was incorporated on November 21, 1991. CMSC commenced business in Michigan on April 1, 1992. Granger Affidavit ¶5, App 67a. At issue are alternative assessments of sales and use taxes. SOF ¶7, App 114a.

The Catalina transactions at issue involved in this appeal are strategic targeted marketing distribution services to product manufacturers, which includes the delivery of the manufacturers'

¹ From January 1, 1991 through April 1, 1992, CMC conducted all relevant business activity at issue in this case. Specifically, CMC identified potential clients among manufacturers and other advertisers, entered into contracts with the clients, furnished the requisite computer equipment and software programming to participating product retailer locations, such as supermarkets, and performed all services under the Checkout Coupon™ Program. Granger Affidavit ¶8, Appendix p 67a–68a. After April 1, 1992, CMSC became responsible for locating potential clients and entering into contracts with them, while CMC continued to contract with product retailers for the installation of computer equipment and software programming which enabled its subsidiary, CMSC, to fulfill its electronic service obligations to its clients. Granger Affidavit ¶9, Appendix p 68a. See also intercompany agreement attached as Exhibit to Wolf Affidavit, App 62a-63a. Thus, after April 1, 1992, CMC and CMSC together performed the same functions previously undertaken by CMC alone. Granger Affidavit ¶¶9, 10, Appendix p 68a.

² Cites to the record are followed by the Appendix page reference hereinafter abbreviated as "App #."

advertising messages and coupons offers to shoppers at the point of sale in retail establishments. See, e.g. SOF Exhibit I, 1992 10-K p 1 and p 2, App 277a-278a. The Checkout Coupon™ Program³ is the first marketing system to use scanned uniform product code (“UPC”) barcodes at the retail checkout line to identify potential product purchasers. Granger Affidavit Exhibit 6, App 83a. Catalina⁴ developed a nationwide computer network linked to its data processing hubs and computer command centers in California and Florida. The network was located in twenty-eight (28) to forty-one (41) states during the years in issue to gather information on consumer selections, preferences, and tastes. SOF ¶¶3, 5, App 112a, 113a; SOF Exhibit I, pp 2-3, App 278a-279a. Personal computers (“PCs”), modems and printers were placed in 4,328 retail stores across the country. SOF Exhibit I, p 2, App 278a; Granger Affidavit ¶12, App 69a. The PCs were linked to the mainframes in California and Florida via telephone line modems. SOF ¶5, p 3, App 113a.

The Checkout Coupon™ Program gathers information about a person’s purchasing patterns based on UPC codes. SOF ¶5, Exhibit I, 1992 10-K, pp 2-3, App 278a-279a. As products are scanned through retail checkout lanes, information is electronically transmitted to the computer hubs in Florida and California. *Id.* During the years in issue, Catalina’s database captured information about the contents of 72.5 million shopping baskets per week. Granger Affidavit ¶12, p 3, App 115a. Catalina’s 1992 10-K filing⁵ explains that the network developed

³ A copy of the brochure describing this program, entitled "Checkout Coupon™ in Action," is attached to the Granger Affidavit. Granger Affidavit, Exhibit 6, App 83a.

⁴ The reference to Catalina here, and though out this Brief, is to CMC before April 1, 1992, and to the collective operations of CMCS and CMC on or after April 1, 1992.

⁵ Catalina’s Form 10-K is filed in accordance with the Securities Exchange Act of 1934.

by Catalina to run the Checkout Coupon™ Program is a system for providing an improved method of distribution of the manufacturers' promotional materials:

The company identified the need to make coupon and related promotion delivery more targeted, effective and cost efficient. Catalina Marketing's nationwide network provides major manufacturers with a level of precision in targeting consumers that was previously unavailable in the coupon industry. The Company believes its electronic marketing network provides manufacturers, retailers and consumers significant advantages over more traditional promotion distribution methods.... The company's primary business is the **delivery** of promotions at the checkout stand through the proprietary Catalina Marketing network, which links the Company's software, personal computers, central data bases and specially designed thermal printers to checkout scanning equipment. SOF Exhibit I, 1992 10-K p 2-3, App 278a-279a [emphasis added].

Catalina utilizes complex data analysis software to analyze this information and identify shoppers that are potential product purchasers based on collected UPC data. SOF ¶5, App 112a-113a; Granger Affidavit ¶12, p 3-4, App 69a-70a. Product manufacturers are then offered the opportunity to purchase exclusive rights to communicate to a preselected target audience of shoppers identified by the Catalina software. SOF ¶¶5, 6, App 112a-114a. To effectively manage exclusivity obligations and distribute targeted promotions on a national, syndicated basis, Catalina offers manufacturer clients the use of its network in time intervals referred to as cycles. Each calendar year is divided into four-week cycles, for a total of thirteen cycles per calendar year. SOF Exhibit I, 1992 10-K, p 3, App 280a. Manufacturers purchase the exclusive use of the network for one or more cycles for a particular product category, thus preventing the possibility of the distribution of competing coupons to the same shopper at the same time. *Id.*, See also SOF, Exhibits A and B, App 118a-124a.⁶ For example, if Catalina sells the premium

⁶ The base fee charged by Catalina for its exclusive use of the network is owed by the manufacturer whether or not a single coupon or ad message is distributed in the product category.

ice cream category to manufacturer X for cycle 1 of 1992, this means that Catalina will only distribute coupons or other promotions pertaining to premium ice cream for X and no other ice cream manufacturer during the time frame corresponding to cycle 1 of 1992. SOF Exhibit I 1992 10-K p 3, App 280a; SOF Exhibits A & B ¶¶ 1.1 and 1.3, App 119a, 122a.

When the manufacturer purchases exclusive communication rights in a UPC product category the manufacturer can choose to communicate by sending an advertising message, a product discount message or sending no message at all for that four week cycle. Granger Affidavit ¶12, p 4, App 70a. The advertising or product discount messages are coupon offers or messages printed on thermal paper. SOF Exhibit I pp 2-3, App 279a-280a; Granger Affidavit Exhibits 2-5, App 79a-82a. The 10-K further explains how the distribution of promotions is effected:

The Company's primary business is the delivery of promotions at the checkout stand through the proprietary Catalina Marketing network, which links the Company's software, personal computers, central data bases and specially designed thermal printers to checkout scanning equipment. The system prints promotions based upon information generated at the point of sale, primarily the purchased products' UPCs. The Company's system evaluates scanner data, matches it with a *programmed promotion* and directs the thermal printer, which is located near the cash register at the point of sale, to print the appropriate promotion. Promotion printing occurs during the checkout process and the promotions are handed directly to the shopper together with their change and the cash register receipt. SOF Exhibit I, 1992 10-K, pp 2-3, App 279a-280a [emphasis added].

The printing is part of the distribution means of the network, which network also includes data collection, analysis, and targeting means. Granger Affidavit ¶11, App 68a; SOF Exhibit I pp 1-5, App 278a-282a.

Product categories are generally purchased by a manufacturer nationally, but the communication may be programmed for regional differences. SOF Exhibit I, 1992 10-K p 3, App 280a. Catalina works with its customers to develop their promotional program. Granger

Affidavit ¶12, p 3, App 69a. Catalina writes software that it electronically downloads into its computer network. *Id.* at p 4-5, App 70a-71a. The software provides electronic instructions to the network computers of the "scanning event" that will trigger communication to a retail store shopper. SOF Exhibit I, p 2-3; App 279a-280a. When the scanning event occurs, electronic computer code transmitted via modem instructs the printers located in retail store to print the message chosen by the manufacturer. *Id.*; Granger Affidavit, Exhibit 6, App 83a-87a. This may be a manufacturer's discount offer or an advertising message.⁷ Catalina did not control the content of the information stated on the paper tape. Granger Affidavit ¶12, App 69a. The retail store was responsible for ensuring that the coupon offer or message printed out (*i.e.*, that printers are loaded with paper, all Catalina network equipment powered up and turned on, etc.) and was handed to the retail store shopper. SOF Exhibit C, ¶¶1a and 3e, App 125a and 127a. In sum, Catalina, through its Checkout Coupon™ Program marketing distribution network, located specifically targeted retail shoppers and provided its product manufacturer customers with communication opportunities. Using software electronically transmitted through its computer network, Catalina assisted its manufacturer customers in the targeted delivery of marketing messages through thousands of retailers across the United States, 24 hours a day, seven days a week.

During the years in issue, product manufacturers who wished to participate in the Checkout Coupon™ Program were required to enter into standard performance agreements to purchase Catalina's electronic targeted marketing distribution services. SOF ¶¶5 and 6, App 112a-114a. Standard performance agreements used throughout the years in issue are attached as

⁷ See Granger Affidavit ¶12, App 70a-72a, for a detailed example of these types of information exchanges.

Exhibits A and B to the SOF, App 118a-124a (the “Performance Agreements”). These product manufacturers were interested in obtaining targeted market data to facilitate promoting particular products. SOF ¶4, App 112a. The Performance Agreement entered into throughout the years in issue by Catalina and the manufacturer identified the product category for which the manufacturer purchased the exclusive communication rights and the four week cycle(s) during which the manufacturer’s rights were in effect. SOF ¶5, Exhibits A & B, p 1, App 119a and 122a.

The Performance Agreements specified a base program fee-the minimum payment required for services provided under the agreement. SOF Exhibits A & B, App 118a-124a; SOF Exhibit I, p 3, App 280a; SOF ¶6, App 113a. The base program fee was paid in advance for each cycle and was retained by Catalina whether or not a single coupon or message was distributed during the cycle. SOF ¶6, App 113a, Exhibits A & B ¶3.0, App 119a and 122a. As the 10-K explains, this base program fee was based upon the value of the product category purchased in terms of the projected consumer reach of the program to be run for that product category. SOF Exhibit I, p 3, App 280a. For example, the base fee for a category for products more frequently purchased by shoppers would be higher than the base fee for a product category for less frequently purchased products (*i.e.*, the consumer reach of the soft drink category would be higher than for the denture adhesive category). Base fees also became higher as more and more retailers participated in the network because more shoppers could be reached.

The Performance Agreement also provided for additional fees, over and above the base fee, to be paid by the manufacturer if the actual offer/message distribution numbers exceeded the projections that went into establishing the base fee. This was the purpose of the "Coupon Rates" set forth on page 1 of the Performance Agreements. At the end of each cycle, if the number of

promotions distributed, multiplied by the appropriate "Coupon Rate" for that type of distribution, exceeded the base fee that has been paid, the manufacturer would be invoiced for the additional amounts, usually subject to a 10% cap, unless the manufacturer had previously agreed that the cap did not apply. The "Coupon Rates" generally varied based upon the type of targeting and data analysis required. SOF ¶¶5, 6, App 112a-114a. For example, if the program identified a purchaser of a competitor's similar product, a rate of \$.06 may have been charged; if a purchaser of a related product manufactured by the same manufacturer was identified, a rate of \$.05 may have applied; and if a purchaser of the same product were identified, a rate of .05 may have applied. An example is provided in ¶5 of the Stipulation of Facts. SOF ¶5, App 113a. The manufacturer agreed to provide all offer information (message content) to Catalina six weeks prior to the program cycle and full payment of the base program fee thirty (30) days prior to program start. *See, e.g.*, SOF Exhibit A ¶¶1.2 and 3.3, App 119a. During the years in issue, the Company's primary source of revenue was from the sale of the product category cycles to manufacturers. SOF Exhibit I 1992 SEC 10K p 3, App 280a.

During the years in issue, Catalina also entered into "Checkout Coupon™ Distribution Agreements" with retailers to participate in Catalina's electronic marketing system. SOF ¶5, App 112a-113a. A standard distribution agreement used during the years in issue is appended to the parties' SOF as Exhibit C, App 125a-132a (the "Distribution Agreement"). The Distribution Agreement stated the retailer's obligation to install and utilize the Checkout Coupon™ system in all its retail outlets with electronic checkout systems compatible with the Checkout Coupon™ software. SOF Exhibit C ¶3, App 126a-128a. The agreement also stated the retailer's obligation to ensure coupons and messages printed, and to distribute all printed messages and coupons to shoppers. SOF Exhibit C ¶1a, 3, App 125a-128a. Under the agreement, the retailer was

authorized to print and distribute coupons for its own benefit "provided such coupons do not conflict with category exclusivity of programs established by Catalina with its manufacturer clients." SOF ¶5, Exhibit C ¶1b, App 125a. CMC supplied, installed and maintained all equipment and furnished the retailer with rollstock (thermal printer paper) and any necessary training documentation. SOF Exhibit C ¶2, App 126a. The retailer provided telecommunications and electrical links needed to connect and operate the equipment and maintained barcodes necessary to allow the Checkout Coupon™ Program to work. SOF Exhibit C ¶3, App 126a. Catalina typically paid the retailer for its distribution of the coupons by paying it a flat fee (such as \$0.005) for each manufacturer coupon printed, as well as an additional sum (such as \$0.0025) for each coupon printed in excess of 50% of the retailer's shopper counts. SOF ¶5, App 113a. Catalina also had the ability to charge the retailer a fee of \$0.035 per coupon for those coupons or promotions printed by the retailer for its private label or in other noncompetitive situations. SOF ¶5, App 113a.

The electronic marketing system known as the Checkout Coupon™ Program was designed to provide several benefits to Catalina's manufacturer customer. Granger Affidavit Exhibits 6 & 7, App 83a-88a. It improves a product brand's marketing position, allows the brand to sustain market share against competitive pressures, enables the manufacturer to direct a retailer to issue coupons to a targeted store shopper, and encourages consumer purchases. *Id.* It also eliminates coupon waste, helps prevent coupon fraud, minimizes coupon misredemption, enables the manufacturer to obtain more control of purchase behavior, and provides flexibility to allow manufacturers' messages to be tailored to different user types and marketing objectives. *Id.* The manufacturers' messages delivered to targeted retail shoppers identified through the

Checkout Coupon™ electronic marketing program had a greater impact on consumer purchase behavior than coupons delivered through conventional means. Granger Affidavit ¶16, App 73a.

From the perspective of Catalina's clients, the electronic marketing activities and information exchange process which resulted in transmission of a manufacturer's directions to distribute or not distribute coupon offers and messages solely involved the provision of computer, informational, and distribution services, and not a transfer of tangible personal property to the manufacturer. Granger Affidavit ¶18, App 73a. The fees paid by the manufacturer for Catalina's Checkout Coupon™ Program services exceed the distributed cost of standard printed coupons distributed through traditional means. SOF Exhibit I, p 8, App 285a.

B. The Department's Audits and Assessments.

The Department conducted a sales and use tax audit of CMC for the period extending from January 1, 1991 through June 30, 1993. SOF ¶7, App 114a. As a result of this audit, the Department simultaneously pursued several mutually exclusive theories of liability which resulted in separate audits of CMC. SOF ¶7, App 114a. The audits, the audit methodologies and audit results achieved by the Department in its examination of CMC for the period extending from January 1, 1991 through June 30, 1993, are summarized in SOF Exhibit D. App 133a-253a.

CMC agreed that its activities in Michigan for the years in issue consisted of the provision of nontaxable services, and that the equipment used to provide those services were subject to use tax. SOF ¶8, App 114a. CMC remitted \$38,002 (plus interest) to the Michigan Department of Treasury in full payment of its Michigan use tax liability assessed by the Department for the period extending from June 1, 1991 through June 30, 1993. *Id.*, App 114a. The Department admitted that CMC paid the entirety of the use tax, penalty and interest liability

determined by the Department for the period extending from January 1, 1991 through March 31, 1992, \$38,002⁸. SOF ¶9, App 114a.

C. Informal Conference Proceedings.

Catalina requested and obtained an informal conference before the Department's Legal and Hearings Division. SOF ¶11, App 114a. The informal conference was conducted by Mary J. Weseloh, an attorney employed by the Department to conduct such conferences, consider arguments, research the applicable law, and issue a recommendation. *Id.* At the conclusion of the process, the hearing referee recommended that Bills for Taxes Due (Intents to Assess) G902765 (issued to CMSC) and G902721 (issued to CMC) be canceled entirely because Catalina's activities constituted the provision of services and not the provision of tangible personal property. [SOF Exhibit F, App 268a-269a]. The Revenue Commissioner disagreed with the hearing referee's recommendations and issued a "Statement of Rebuttal," affirming the assessments. SOF ¶12 Exhibit E, App 254a-267a.

D. The Assessments.

On December 1, 1995, the Department issued Bill for Taxes Due (Final Assessment) G902765 assessing CMSC additional Michigan sales tax for the period from January 1, 1992 through June 30, 1993 in the amount of \$263,067.00 in tax and \$61,622.83 of interest for a total alleged sales tax liability of \$324,701.83. SOF ¶13, App 115a. On December 1, 1995, the Department issued Bill for Taxes Due (Final Assessment) G902721 assessing CMC additional Michigan sales tax for the period extending from January 1, 1991 through March 31, 1992 in the amount of \$44,092.00 in tax and \$15,072.23 in interest for a total alleged sales tax liability of \$59,154.23. SOF ¶14, App 115a. CMC and CMSC timely appealed these final assessments to

⁸ A copy of Respondent's Response to Petitioners' First Request for Admissions to Respondent is

the Michigan Tax Tribunal ("MTT"), and the MTT consolidated these cases, MTT Docket Nos. 231397 and 231398.⁹

E. The MTT's Final Order and Court of Appeals Opinion.

On April 16, 1998, Catalina and the Department filed cross-motions for summary disposition of the matters at issue in this case. The parties jointly filed the Stipulation of Facts to facilitate the MTT's consideration of the cross-motions. Catalina based their motion on MCR 2.116(C)(10). Catalina supported its motion for summary disposition with the sworn affidavits of Mr. Wolf and Mr. Granger which, *inter alia*, addressed the business activities engaged in by Catalina, explained the intent and operation of the various agreements that Catalina entered into with manufacturers and with retailers, and described in some detail the Checkout Coupon™ Program related to these arrangements and transactions. The Department purported to base its motion for summary disposition on MCR 2.116(A) and (B).¹⁰ The Department provided no contrary affidavits in support of its motion for summary disposition, nor did it supply any contrary affidavits in its reply to Catalina's motion in response to Mr. Wolf's and Mr. Granger's affidavits, leaving Mr. Wolf's and Mr. Granger's factual testimony unrebutted.

On August 9, 1999, the MTT issued its Final Order [App 14a-58a] in which it appears to provide what it purports as "Findings of Fact" and "Conclusions of Law." In its "Findings of Fact" the MTT briefly references the Revenue Commissioner's purported reliance on the decision in *Shelby Graphics, Inc. v Dep't of Treasury*, 5 MTT 63 (Docket No. 83611) (1986), and

appended to the parties' SOF. [SOF Exhibit E, App 254a-267a].

⁹ A portion of the audit period for CMC overlaps with a portion of the audit period attributable to CMSC. See Granger Affidavit ¶7, App 67a. The parties have agreed that only one entity is obligated for payment of sales tax attributable to any given portion of the years in issue. SOF ¶6, App 114a.

Revenue Administrative Bulletin 1995-1 (hereinafter "RAB 95-1") as "requiring adherence to the 'real object' test" in addressing the sale of tangible personal property vs. service issue. [Final Order, pp 14-15, App 27a-28a]. The Opinion of the Court of Appeals [App 50a-58a] affirmed the decision of the MTT.

F. Order Granting Leave to Appeal.

Plaintiff-Appellants applied, pursuant to MCR 7.302, for Leave to Appeal from the per curiam opinion issued by the Court of Appeals on March 5, 2002 (hereinafter, the "Opinion"), the rehearing of which was denied by Order dated May 10, 2002. Leave to Appeal was granted by this Court's Order dated March 25, 2003 to address the issue of, "whether petitioners' "Coupon Checkout Program" constitutes "sales at retail" under MCL 205.52?" This Brief, therefore, focuses upon the application of the statute to the facts of this case, without further discussion of the alternate issue of the mutually exclusive multiple sales and use tax assessments. If this matter is remanded for an evidentiary hearing, Catalina reserves the right to pursue its proofs concerning these alternative claims.

G. The Record.

This case was adjudicated based on cross-motions for summary disposition and no hearing occurred at the MTT in connection with these matters. Accordingly, there is no transcript to which the parties to this appeal can refer. Therefore, the primary factual record consists of the *Statement of Stipulated Facts* ("SOF") (which has nine exhibits attached), and the affidavits submitted by Plaintiff-Appellant in support of its motion for summary disposition: the Affidavit of Christopher W. Wolf, Treasurer for Catalina Marketing Corporation ("Wolf Affidavit") (with one exhibit) and the Affidavit of Daniel D. Granger, President and CEO of

¹⁰ In its Order, the MTT treats the Department's motion as one based upon MCR 2.116(C)(10).

Catalina Marketing Corporation ("Granger Affidavit") (with seven exhibits).¹¹ All of these documents were submitted in an Appendix by Petitioners-Appellants in the Court of Appeals and are submitted with this Brief in accordance with MCR 7.307(A) as the Appendix.¹²

ARGUMENT

I. Standard of Review – The MTT Committed Reversible Error Which Was Upheld in the Court of Appeals Based on Inappropriate Deference to the MTT’s Decision Under the Wrong Standard of Review.

This matter was submitted to the MTT on cross-motions for Summary Disposition, a Stipulation of Facts and Affidavits of two employees of Petitioner-Appellant. The MTT granted summary disposition based on the determination that there was no genuine issue as to any material fact and that judgment should be entered as a matter of law. Judicial review of the grant of summary disposition by the MTT (especially under MCR 2.116(C)(10)) is *de novo*. *International Business Machines v Dep't of Treasury*, 220 Mich App 83, 86; 558 NW2d 456 (1996) lv den 456 Mich 883; 570 NW2d 656 (1997). The Court of Appeals below declared that although it may have reached a different result in this case, it would defer to the MTT decision because it did not find "legal error" or that the MTT decision "is not supported by competent, material and substantial evidence." Court of Appeals Opinion, pp 7-8, App 56a-57a. In doing so, the Court of Appeals applied the wrong standard of review and incorrectly concluded that the

App 15a

¹¹ The MTT denied the Department’s motions to strike the original and revised affidavits of Mr. Wolf and Mr. Granger stating, “the revised affidavits will be given the weight which the Tribunal, in its discretion, considers merited and appropriate.” MTT Final Order p 28, App 41a. Additionally, the Granger and Wolf affidavits [App 61a, 67a] are supported by and consistent with the 10-K reports [App 277a-316a] and the Performance Agreements [App 118a, 121a] both of which were created prior to this litigation. See, *e.g.*, 10-K for year ended March 31, 1992, App 277a-316a.

¹² Under MCR 7.307(A)(5), the Appendix must contain "any relevant portion of the pleadings or other parts of the record." Accordingly, the Appendix in this matter includes the entire Court of Appeals Appendix.

MTT decision was supported by competent, material and substantial evidence, when, in fact, that standard is irrelevant because there was no evidentiary hearing or finding of facts. Moreover, the record evidence does not support the MTT's decision.

The Michigan Constitution (Const 1963, art 6, §28) limits judicial review of a final decision of the MTT, absent fraud, to the questions of whether the MTT committed an error of law or adopted a wrong legal principle. *Antisdale v Galesdure*, 420 Mich 265; 362 NW2d 632 (1984). Factual findings of the MTT are not subject to review provided they are supported by "competent, material and substantial evidence on the whole record." Const 1963, art 6, §28. Because this matter was adjudicated under a summary disposition motion, the MTT decision does not contain any findings of fact. Tribunal Opinion, App 14a. *Ann Arbor Township v State Tax Commission*, 393 Mich 682; 227 NW2d 784 (1975). Thus, despite the heading called 'findings of fact' contained in the MTT's final order, there was no finding of fact by the MTT as a matter of law to which the Courts owe any deference. Therefore, this Court has *de novo* review of not only the legal principles, but the weight and characterization of the pertinent facts.

II. Overview of Arguments.

Catalina sells a service that allows manufacturers to locate and identify shoppers whose buying patterns correspond to certain criteria that a manufacturer/client has specified after consultation with Catalina. When Catalina's information processing system locates a shopper meeting criteria specified by the manufacturer, Catalina electronically implements the instructions of the manufacturer regarding that shopper. One of three events results from the new information obtained about each shopper: coupon offers are distributed to that shopper, an advertising message is distributed or, most frequently, the manufacturer has chosen not to communicate with the shopper. These services are most accurately described as strategic targeted marketing distribution services.

The question presented in this case is whether this activity constitutes a sale at retail of tangible personal property by Catalina in the State of Michigan. Catalina sells its Checkout Coupon™ Program to manufacturers; therefore, the transaction at issue is not between Catalina and supermarket shoppers.¹³ Treatment of the program as “the sale of coupons” ignores the reality of the transaction.

Under the Sales Tax Act¹⁴, a taxable “sale at retail” means a transaction by which the transfer of ownership of tangible personal property is made in the ordinary course of the seller's business to a buyer for other than resale. The sales tax, simply put, is an excise tax on the retail sale of tangible personal property. Catalina is selling electronic marketing and distribution services, not tangible personal property. These services are not transformed into sales of property by the fact that one of the services that sometimes occurs is the distribution of an electronic message to print a coupon offer or advertising message specified by the manufacturer, which is then handed to the shopper for free by the retailer. This type of electronic marketing and distribution network is not what the legislature had in mind when it imposed a tax on sales at retail, irrespective of the fact that a low-quality piece of thermal printed paper is the medium for delivery of the manufacturer’s message to the targeted shopper.

To determine whether a transaction is a “sale at retail” under MCL 205.52, the Courts have weighed the facts and circumstances of the transaction¹⁵ and have looked to see whether the

¹³ The shopper is not the “consumer” as designated by the Department’s Brief in Opposition to Leave of Appeal. Brief in Opposition beginning at p 5, and throughout. Catalina sells nothing to shoppers. The Checkout Coupon Program is sold by Catalina to the manufacturers of the products sold in the grocery store.

¹⁴ The Sales Tax Act was enacted as 1933 PA 167; MCL 205.51, *et seq.*

¹⁵ *Liquid Dustlayer, Inc. v Department of Treasury*, unpublished opinion per curiam of the Court of Appeals decided September 12, 2000 (Docket No. 217912) lv den 464 Mich 857; 630 NW2d 332 (2001).

sale of property is incidental to services provided.¹⁶ The Court below mistakenly felt compelled to follow the Department's "administratively legislated" real object guideline.¹⁷ After making that error of law, it also mistakenly deferred to the MTT's factual interpretation that the real object of the transaction is the creation and sale of tangible property as opposed to data collection, shopper analysis and distribution services, notwithstanding that it was apparently persuaded that the paper was an inconsequential and incidental aspect of Catalina's services.

Any analysis applied under a proper standard of review results in the conclusion that Catalina's sale of its electronic targeted marketing distribution system, the Checkout Coupon™ Program, is not a sale at retail. All the facts and circumstances demonstrate that Catalina is selling exclusively services.¹⁸ The Department has argued, and the Courts have agreed, that a service transaction that includes a tangible personal property component is still entirely the sale of a service if that is the character of the transaction, *see e.g., Manatron, Inc. v Dep't of Treasury*, 4 MTT 537 (Docket No. 84131) (1986) (property tax forms distributed to government); and

¹⁶ *University of Michigan Board of Regents v Department of Treasury*, 217 Mich App 665; 553 NW2d 349 (1996).

¹⁷ The Department applied and expanded the real object test under Revenue Administrative Bulletin 95-1 based on the MTT decision in *Shelby Graphics*. Other precedential Michigan Appellate case law was ignored by the RAB which is not adopted in accordance with the Administrative Procedures Act, and merely states the Department's interpretation of current laws. MCL 205.3(f). *See also, Danse Corp. v City of Madison Heights*, 466 Mich 175; 644 NW2d 721 (2001) remanding unpublished opinion per curiam of the Court of Appeals, decided March 23, 2001 (Docket No. 215486), *aff'd* 10 MTT 399 (Docket No. 230939, October 13, 1998).

¹⁸ The nature of the contract is a purchase of Catalina's targeted marketing services for a four week cycle for which the manufacturer pays a base fee, irrespective of whether coupons are distributed, in order to secure the exclusive right to Catalina's marketing services for that time period. *See, e.g.,* SOF Exhibits A & B, App 118a & 121a. The contract pricing is based on the targeting services provided, which rewards Catalina for locating the more difficult to find shoppers. Catalina merely transmits to supermarkets an electronic version of the manufacturer's coupon or message, where the manufacturer owns all coupon or message content, and then distributes the coupon or message by printing it out on thermal printer paper so the retailer can hand it to the targeted shopper.

Maccabees Mutual Life Ins. Co. v Dep't of Treasury, 122 Mich App 660; 332 NW2d 561 (1983) (sale of custom software on computer disk is services); *also see, Holy Spirit Ass'n for Unification of World Christianity v Dep't of Treasury*, 131 Mich App 743; 347 NW2d 707 (1984) (distribution of property in return for a donation is not a sale at retail); it is not transformed into a retail sale if the property is incidental to such a service transaction. *University of Michigan Board of Regents, supra*, note 16.

The Court of Appeals apparently agreed with Catalina but wrongly deferred to the MTT's factual interpretation and failed to apply *de novo* review to a finding of summary disposition as a matter of law.

Catalina is engaged in a unique and highly sophisticated business. It asserts that when the following is properly understood about its business:

1. it contracts for the sale of its services based on time periods and product segment exclusivity,
2. it prices such services based on the volume of the market to be analyzed, the projected consumer reach of the marketing programs selected by the manufacturer, and the degree of rarity or desirability of the shoppers it ultimately locates for the manufacturer,
3. it does not create or produce coupons, but rather transmits electronically the instructions of the manufacturer to print the manufacturer's message to the shopper as a distribution means, and

4. the use of paper to deliver the manufacturer's message to the shopper does not define the nature of the transaction because the manufacturer is not in any conceivable way buying that piece of paper from Catalina,

then this Court will conclude:

- (A) Catalina provides non-taxable services to its manufacturer/clients consisting of analyzing and processing data gathered from retail purchases and distributing the results,
- (B) there is no tangible property sold at retail in Michigan, and
- (C) if coupons are viewed as tangible property transferred by Catalina, they are only incidental to the provision of a service.

III. The Transaction between Catalina and the Manufacturers Is Not a "Sale at Retail" of Tangible Personal Property as that Term is Used and Defined in the Statute.

A. Plain Language of the Statute Imposes Tax on the Sale of Tangible Personal Property, Not Services Contracts.

The starting point for determining whether the Checkout Coupon™ Program is a "sale at retail" is with the plain language of the statute. During the years in issue, MCL 205.52(1) provided:

there shall be collected from all persons engaged in the business of making sales at retail, as defined in section 1, an annual tax for the privilege of engaging in that business equal to 4%¹⁹ of the gross proceeds of the business

¹⁹ The language of MCL 205.52(1) is currently unchanged except that, beginning May 1, 1994, the sales tax rate was changed to 6%. Senate Joint Resolution S of the 87th Legislature approved by voters of Michigan on March 15, 1994 as Proposal A.

The referenced definition is found in MCL 205.51(b), which defines a sale at retail as:

a transaction by which the ownership of tangible personal property is transferred for consideration, if the transfer is made in the ordinary course of the transferor's business and is made to the transferee for consumption or use, or for any purpose other than for resale . . . (emphasis added)

Under the plain language of the statute, sales tax applies only to sales of tangible personal property, not sales of services. Only specific statutorily defined intangibles and services, not applicable to the case at hand, are subject to sales tax.²⁰ Thus, Catalina's sales to its manufacturer customers may only be subjected to sales tax if the transactions constitute a sale of tangible personal property for the consumption or use by the manufacturer. Where "the applicable statutory sections are clear and are not open to construction or interpretation...the plain meaning of the language in the statute must be followed." *Soap and Detergent Ass'n, et al v Natural Resources Comm*, 415 Mich 728, 738; 330 NW2d 346 (1982). *See also, Atty General of the State of Michigan, ex rel Dep't of Natural Resources v Sanilac County Drain Commissioner, et al*, 173 Mich App 526, 531; 434 NW2d 181 (1988), ("All language in a statute is presumed to have meaning and no word or phrase is to be treated as surplusage or rendered nugatory where possible."); *PM One Limited v Dep't of Treasury*, 240 Mich App 255, 280; 611 NW2d 318 (2000), ("...the courts must apply unambiguous statutes as written, construe them reasonably when necessary, and make every reasonable effort to give meaning to all the words in the statute to avoid nullifying the Legislature's intent").

²⁰ Sales of transmission and distribution services for electricity are subject to tax under MCL 205.51(d). Intangibles such as electricity, natural or artificial gas, or steam and certain computer software are also statutorily designated as subject to sales tax. *See* MCL 205.51(d) and (e).

Catalina's sales of the Checkout Coupon™ Program are sales of services, not tangible personal property. The Department and the Court below have mischaracterized the transaction. The contract is written as a sale of the exclusive right to communicate with shoppers for a quantity of time, not as a sale of a quantity of property. SOF Exhibit A and B ¶¶1.0, 2.1, App 119a, 122a; Granger Affidavit ¶12, App 68a-72a. The sales contract is devoid of any detailed description of the tangible property to be transferred. *Id.* Rather, the contract states that the manufacturer is responsible for the look, feel and content of any resulting property issued in the form of a coupon. *Id.* at ¶1.2, App 119a, 122a. Catalina's responsibilities are limited to identifying shoppers based on electronic data entered into its computer network when a shopper's products are scanned, and for remotely sending electronic software programming to the computers on its network to cause the manufacturer's desired result upon the occurrence of a pre-identified scanning event. SOF ¶5, App 112a-113a. The manufacturer decides whether, in response to a scanning event, a discount coupon issues, an advertising message issues, or nothing issues. Granger Affidavit ¶12, App 69a-70a. Thus, there are no coupons sold by Catalina to the manufacturer, but rather Catalina sold to the manufacturer services that sort through a continuous stream of shoppers, identify shoppers for the manufacturer to communicate to in the form of an advertising message or coupon offer and provide distribution services for the manufacturer's communication. Granger Affidavit ¶¶14, 18, Exhibit 6, App 72a, 73a, 83a. This is not a sale of tangible property under the plain language of the statute; therefore, this does not constitute a sale at retail within MCL 205.52.

B. Legislative Intent Does Not Extend to Taxation of Electronic Services Contracts.

When the legislature enacted the sales tax act in 1933,²¹ the electronic services at issue in this matter obviously did not even exist. Thus, the legislature could not have intended to tax sales of electronic marketing and distribution services. In fact, subsequent legislation has continued to limit the reach of the sales tax only to sales of tangible property with only a few exceptions not applicable to this case.²²

Here, the Department is attempting to extend the definition of “sale at retail” to a sale of strategic targeted marketing distribution services that include the delivery, by printing, of the manufacturer’s coupon offer. The Department may not extend liability for the sales tax beyond the legislative intent through its rulings or revenue administrative bulletins. *Gainey Transp Service, Inc v Dep’t of Treasury*, 209 Mich App 504; 531 NW2d 774 (1995); *Howard Pore, Inc v Nims*, 322 Mich 49; 33 NW2d 657 (1948). The Department and the Court below have misconstrued the transaction and applied sales tax to targeted marketing distribution service transactions contrary to the legislative intent. The legislative intent has never been interpreted by this Court, or indeed any court in Michigan prior to this case, to encompass a transaction overwhelmingly limited to services.

Catalina does not sell tangible personal property. It sells exclusive rights to use its ability to identify shoppers to whom coupon offers or messages should be issued based on UPC scanning at checkout counters. SOF Exhibit I, App 280a; Granger Affidavit Exhibits 6 and 7, App 83a and 88a. Catalina is not a creator or producer of coupons. Catalina merely sends electronic print instructions which trigger remote printing of coupon offers and messages by

²¹ The General Sales Tax Act was enacted as 1933 PA 167.

²² As discussed earlier, the statutory exceptions to this rule are not herein applicable. See note 20.

thermal printers as a means of distribution at retail checkout. SOF Exhibit I p 2, App 279a; Granger Affidavit ¶12, p 4, App 70a. Catalina's contracts with retailers obligate the retailer to distribute the coupons that are printed as a result of the scanning event identified by Catalina's strategic targeted marketing services. SOF Exhibit C ¶1a, App 125a. The sales transaction occurred at the time Catalina and a manufacturer entered into a performance agreement outside of Michigan. At that time, there was no coupon, message or any other property transferred from Catalina to the manufacturer. SOF Exhibits A and B, App 118a and 121a. Instead, the parties contracted for Catalina to target shoppers and to distribute coupons and messages to such targeted shoppers for a predetermined time period using Catalina's nationwide computer network.²³ It is very clear that the "coupon information" to be included on resulting coupons/messages is supplied by and belongs to the manufacturer. *See* SOF Exhibit A, Mexican Salsa Performance Agreement Paragraph 1.2 (App 118a-120a). The brand name, logo, trademark, etc. are at all times the property of the manufacturer. Granger Affidavit ¶12, App 69a. At the time the contract is executed, the content of any coupon to be issued in the future and decisions as to whether any coupons will be issued at all belongs solely to the manufacturer. *Id.* Catalina merely provided electronic distribution services for these coupons. There was no tangible property sold by Catalina in Michigan. Therefore, under MCL 205.52, there was no sale at retail to tax.

Thus, the lower court erred in finding a sale at retail in contravention of the statutory language and without any precedential judicial support for interpreting the legislative intent to

²³ Catalina described its business as "the distribution of coupons for manufacturers" in its Distribution Agreements with retailers. SOF Exhibit C ¶4, App 128a. "Checkout Coupon" is merely the trademark developed by Catalina to promote goodwill and recognition of its services in the marketplace.

cover such a new service technology. Where the language used is clear and unambiguous, the manifested legislative intent must be recognized. *Boyer-Campbell Co v Fry*, 271 Mich 282; 260 NW 165 (1935); *Gardner-White Co v Dunkel*, 296 Mich 225; 295 NW 624 (1941). Catalina identified target shoppers and transmitted instructions to trigger a manufacturer's designated message to be printed. Under the Checkout Coupon™ Program, the retailer oversaw the printing and distributed the manufacturer's message or the manufacturer's promise to discount the price of a product. This transaction was not the sale of "property,"²⁴ and it was not a sale at retail in Michigan.

IV. Under a Facts and Circumstances Analysis, Catalina Provided Strategic Targeted Marketing Distribution Services.

The Michigan Courts have weighed the facts and circumstances of each transaction to determine if a retail sale has occurred. See *Maccabees Mutual Life Ins Co v Dep't of Treasury*, 122 Mich App 660; 332 NW2d 561 (1983); *Detroit Automobile Inter-Insurance Exchange v Dep't of Treasury*, 138 Mich App 696; 361 NW2d 373 (1984) (hereinafter "*DAIIE*"). Under a facts and circumstances analysis, the Court of Appeals has based its determination on whether the basis for the contract price was for services or tangible property. *Liquid Dustlayer, Inc v Dep't of Treasury*, unpublished opinion per curiam of the Court of Appeals decided September 15, 2000 (Docket No. 217912) rev'g MTT Docket No. 240837 (1999), *lv den* 464 Mich 857; 630 NW2d 332 (2001). The court has looked at the essence of the transaction and control over tangible property. *Id.*; *Flexitype & Douglas Offset Co v Dep't of Treasury*, 52 Mich App 153; 216 NW2d 609 (1974). The Court of Appeals has also regularly applied the "incidental to services" test which looks to whether the property involved in the transaction is incidental to the

²⁴ Even if "property" were transferred, it was intangible property. See *infra* at pp 32-35 and fn 36.

sale of services and therefore nontaxable. *University of Michigan Board of Regents v Dep't of Treasury*, 217 Mich App 665; 553 NW2d 349 (1996); *Manatron v Dep't of Treasury*, 4 MTT 537 (Docket No. 84131) (1986). However, regardless of the analysis this Court chooses to apply, Catalina's sales of the Checkout Coupon™ Program are sales of services, not retail sales of tangible personal property.

A. The Essence of the Transaction between Catalina and the Manufacturer is Gathering and Processing Information, Targeting Shoppers and Distributing Manufacturer Communications, Including Coupon Offers Through a Nationwide Computer Network.

Custom software has long been recognized as a sale of services, not tangible property, by the courts because of the primacy of the services at the heart of the contract. *Maccabees, supra*; *DAIIE, supra*. Without the services, the focus of the transaction would not exist. For example, in *Maccabees*, the Court of Appeals examined the facts and circumstances and concluded that the transactions were the nontaxable transfer of services/intangibles. The Court of Appeals found particularly relevant expert testimony that, “In contrast [to canned programs], the programs in question are customized application programs, needing pre-lease consulting and continuing on-site updating, and are not an end product in themselves.” 122 Mich App at 665. Similarly, in *DAIIE*, the Court noted that “since the system had to be tailored to the specific use therein involved, it was not taxable.” 138 Mich App at 699. Thus, the Court of Appeals has held that where a contract requires extensive customized services, the nature of the transaction was the purchase of the specialized services.

In this case, the purchase of the Checkout Coupon™ Program is a purchase of specialized services. The unique value inherent in the Checkout Coupon™ Program is the fact that it is a revolutionary new way to identify shoppers for the manufacturer. Any graphic design or print company can design and print flashy coupons but during the audit years only Catalina could

capture shopper preferences and purchasing information based on data gathered from thousands of retail checkout lines in 28-41 states. Only Catalina could analyze that information and work with the manufacturer to design a customized software program to identify the ideal target shopper for the manufacturer's message based on the manufacturer's individual needs and product to be marketed. Only Catalina had a computer network through which it could send out the software program to trigger the transfer of the manufacturer's message when a pre-programmed scanning event occurred. Only Catalina could assure a manufacturer of distribution of its coupon offer, advertising message, other promotion or incentive, to the targeted shopper at the checkout counter. The essence of the transaction between Catalina and the manufacturers was the sale and purchase of these data gathering, data analysis, marketing and distribution services. Personalized services based on UPC codes are the bargained for value, just as they are for custom software.²⁵ In *Maccabees*, the Court focused on the uniqueness of the software and that the programs were unusable by other firms as supporting a services classification. 122 Mich App at 665. The value from the purchase of the Checkout Coupon™ Program is Catalina's analysis and creation of a customized electronic marketing program to suit the manufacturer's needs that is downloaded into its computer network. Granger Affidavit ¶12, p 3, App 69a. The Checkout Coupon™ Program provides customized programming that allows manufacturers to reward heavy product purchasers, encourage multiple purchases, target related product purchasers and to provide geographic variations. See SOF Exhibit I 1994 10-K at p 4, App 337a. Moreover, Catalina's data analysis assures manufacturers that Catalina can customize its program for each manufacturer so that its coupon offer or message is only distributed to those

²⁵ Even the Department concedes that where a seller contracts to provide individualized services based on the exclusive needs and use of a particular customer, it is a service contract. See

shoppers that the manufacturer wants to target. *Id.* Because Catalina provides these specifically tailored services to each manufacturer client and because these targeting services must occur before any coupon is distributed, this Court should hold that the essence of the Checkout Coupon™ Program is services.

B. Coupons Are Analogous to Text Messaging Where Catalina is in the Role of the Cellular Phone Company.

The Department argues that Catalina's services are worthless without the transfer of paper to a shopper; therefore, the transaction must be a retail sale of a paper coupon. Respondent-Appellee's Brief in Opposition to Application for Leave to Appeal at p. 16. This is not true. Most of the time Catalina's services are used to determine that a particular shopper is not within the targeted group and will receive nothing. Moreover, Catalina's services would be just as valuable if another means were used to distribute the manufacturers' offers and messages to only the targeted shoppers. The paper used to deliver the manufacturers' message to the targeted shopper is irrelevant to determining the nature of the transaction. The essence of the transaction is services, just as it is for the comparable services of text messaging available on most cellular phones. For text messaging, the cell phone owner enters a message and the phone number of the desired recipient and pushes a button to transmit. The cellular phone company provides the software and network to deliver the message to the targeted person. Under the Checkout Coupon™ Program, the manufacturer decides what message to send and tells Catalina to whom to send it. Similarly, Catalina merely offers the communication opportunity and distributes the message for the manufacturer. Catalina is similar to the cellular phone company in that it provides the software and network to deliver the message to the targeted person. Catalina provides the additional service of locating the targeted shopper.

Revenue Administrative Bulletin 1995-5 (custom software is a service).

Like a cellular phone company, Catalina performs its services electronically. Catalina transmitted an electronic software program from its computer hubs located in Florida and California to each PC on its computer network. The software program instructed the printer in each retail store whether or not to print a coupon or message when a shopper's item was scanned at the checkout. SOF ¶5, App 69a. The printed paper is merely the medium for the transmission of the manufacturer's message to the targeted shopper. Catalina could also have installed equipment to issue the message or offer at the checkout via display with an ID number to use to redeem the offer in a future visit, rather than print a slip of paper. Where the essence of the transaction is services, the medium for delivery of those services is not controlling. In *Maccabees*, the Court of Appeals cited with approval expert witness testimony stating that tangible personal property related to custom software is irrelevant because software exists as binary pulses that can be transmitted without the tangible property. *Maccabees*, 122 Mich App at 664. Similarly, Catalina has fulfilled its contract by identifying targeted shoppers and by the electronic transmission of the manufacturer's message as binary pulses over the phone lines to the PCs and printers on its network. This Court should find that Catalina's transmission of electronic print orders is not a sale of the paper used to transmit the manufacturer's message to the target shopper.

C. Price of Transaction Is Based on the Nature of the Marketing Services Performed.

The Court need not struggle with the task of defining the true nature of the transaction between Catalina and the manufacturers as the contracting parties have revealed that nature and the character of their relationship in their contracts. As recognized in *Liquid Dustlayer*, the pricing of the transaction is an important variable, perhaps the most important, and serves to prove what the manufacturer is attempting to purchase and clearly reveals what Catalina is

selling. In *Liquid Dustlayer, Inc v Dep't of Treasury*, unpublished per curiam opinion of the Court of Appeals decided September 15, 2000 (Docket No. 217912) rev'g MTT Docket No. 240837 (1999), *lv den* 464 Mich 856; 630 NW2d 332 (2001), the Court of Appeals had to determine whether the provision and application of liquid calcium chloride to public roads constituted a service transaction or an exempt sale at retail to a governmental entity. The Court of Appeals looked to how Liquid Dustlayer priced the transaction to determine whether it was primarily selling the product or selling its services. The fact that the contract was for a set amount of liquid calcium chloride and the price was primarily based on the cost of the property supported the conclusion that the transaction was a sale of the tangible personal property, not delivery services. An analysis of Catalina's pricing under the Performance Agreements shows that Catalina's pricing is based on services.²⁶

1. Manufacturer Purchases Marketing Information and a Communication Opportunity with Shoppers, Not Tangible Personal Property.

The value the manufacturer is purchasing and Catalina is selling is best understood by the basic pricing of Catalina's services.

As described in the Court of Appeals decision at p 2, App 51a:

[A] rate of \$0.06 may have been charged for each coupon issued upon the purchase by a consumer of a competitor's similar product; a rate of \$0.05 per coupon for a coupon issued to promote a different product manufactured by the manufacturer of a product purchased by a consumer (e.g. a coupon for Company X's refried beans may issue upon the purchase of the Company X's salsa); and a rate of \$0.035 per coupon to promote the same product purchased by a consumer.

²⁶ The MTT and the Court of Appeals analyzed the contract pricing, but, unfortunately, misunderstood the essence of the contract and the transaction in characterizing the pricing as determined by a type of coupon or advertising rather than the targeting method and the value of the product category purchased.

In each of these cases, the printed coupon is the same. Granger Affidavit, Exhibits 2 through 5, App 79a-82a. What is different, and what is priced differently, is the nature of the identification services provided by Catalina. The manufacturer is most interested in identifying shoppers who are actually purchasing competitors' products. Therefore, the contract financially rewards Catalina for developing and implementing the software and the marketing analysis to target these shoppers. What the manufacturer decides to do once Catalina has identified and categorized these shoppers is up to the manufacturer. Catalina's job is to provide the information and analysis to enable the manufacturer to decide the most efficient incentive to give to each shopper, and this is what determines the pricing of Catalina's services under the contract. Whether the content the manufacturer has specified to be distributed contains graphics, logos, or just plain text message is not relevant to determining the price. Under the Performance Agreements, the amount a manufacturer actually pays to Catalina is wholly dependent on the nature and type of targeted marketing distribution services performed by Catalina, the number of 4 week cycles purchased, and the value of the product category purchased. SOF Exhibits A and B, App 118a-124a.

Catalina's pricing structure is similar to an express mail delivery service. Like an express mail company, Catalina receives the item to be delivered and the delivery address from its customer. Catalina provides the service of locating the delivery point – the targeted shopper. Express mail companies charge for their services by weight of the packages, distance to be covered, the number of packages delivered, and the speed of delivery. Catalina charges for its services by difficulty of locating the shopper, the value of the product category, and the number of communications delivered. No one claims that an express mail company is conducting retail sales of the tangible boxes it utilizes in its delivery service, even though they affect pricing. Just

as the express mail company is not engaging in a sale at retail by delivery of the package to the final destination in a box provided by the company, neither is Catalina engaging in a sale of coupons by electronically distributing the manufacturer's coupon through its computer network.

2. A Fixed Base Fee is Paid to Catalina for its Targeting Services.

The primary value to the manufacturer from its contractual relationship with Catalina is the exclusivity of the contract. Most often, Catalina's performance of its contractually specified targeted marketing services, in accordance with the criteria in the contract, will result in no coupon being issued by a manufacturer at all. Yet the manufacturer still pays a significant base fee to Catalina. A typical base fee under the performance contract is \$60,000 to \$75,000 [SOF Exhibits A and B, App 118a and 121a], which includes the exclusive right to Catalina's services for a four week cycle for that product category. Catalina will not perform its targeted marketing distribution services for a competitor during that cycle. The manufacturer is purchasing Catalina's electronic marketing and targeting distribution services for the entire four week period, including those periods of time when the software program runs and identifies a shopper as not a targeted shopper. In other words, the manufacturer purchased services that identified those shoppers to whom communications should not be issued. This service created valuable savings to Catalina's customers. Granger Affidavit ¶16, App 73a. The Court of Appeals failed to appreciate the fact that the pricing framework is based on sales of services, and not coupons which are frequently not printed and distributed.²⁷

This arrangement would make no commercial sense if viewed as a contract for the sale of tangible property because it requires payment even if no tangible property is received. However, when one considers the exclusivity provision of the contract, it is not only consistent with a

²⁷ In any case, the coupon is neither tangible property nor sold to the manufacturer by Catalina in

services contract, but highlights one of the primary appeals of the program offered by Catalina. When Catalina enters into a contract with a manufacturer, Catalina is prohibited from providing marketing services or instructing retailers to distribute coupons of competitors' products for the contract duration for that product category based on UPC codes. Moreover, the manufacturer could pay the base fee and not issue any coupons, but prevent competitors from issuing coupons through the Catalina system. Exclusivity is a valuable and logical aspect of the marketing services of Catalina, and a clear rationale supporting the payment of a base fee. Manufacturers pay a minimum base fee for the services provided by Catalina. The Performance Agreements are service contracts.

V. The Strategic Targeted Marketing Distribution Services Performed by Catalina Do Not Involve the Manufacture of a Coupon.

The Department has argued that this case is controlled by two cases involving printed advertising materials, *Shelby Graphics v Dep't of Treasury*, 5 MTT 63, 69 (Docket No. 83611) (1986) and *Speaker-Hines & Thomas Inc v Dep't of Treasury*, 9 MTT 129 (Docket No. 88326) (1991) aff'd on other grounds 207 Mich App 84; 523 NW2d 826 (1994).²⁸ These two cases are clearly different from the case before this Court because in each case the seller created a tangible product that it owned and then transferred to its customer. Catalina did not own or manufacture the "coupon" it distributed. Catalina merely electronically transmitted a message or offer.

A. Manufacturer Owns All Content Distributed to Shoppers.

Product manufacturers, assisted by Catalina, developed their particular promotional programs. In reliance upon the marketing expertise of Catalina, manufacturers established the

Michigan.

²⁸ The MTT is a legislative, not constitutional, court. Accordingly, it lacks the general powers to interpret Michigan statutes and the Michigan Constitution and bind other courts with their opinions. See *Tax Tribunal Act*, MCL 205.701, *et seq.*; 1973 PA 186.

“scanning event” which triggered the exchange of information between the computer hubs and the PC located at the supermarket site. Not only did Catalina not design the appearance or create the information that appeared on coupons and advertising messages, and not only was the content of the information, and thus the nature of the coupon or promotional message, dictated by the manufacturers, but at all times all such content on the paper tape remained the property of the manufacturers. Granger Affidavit ¶12. The manufacturers also determined the response that would be made as a consequence of the “scanning event,” *i.e.*, whether a tape bearing a money-off coupon offer or simply a message would be provided. Granger Affidavit ¶12, App 69a.

In *Shelby Graphics*, the company created the content of the advertising message in a tangible form. There was no question that Shelby owned and conveyed the product created to its customer. Similarly, the printing company in *Speaker-Hines* had to transfer not only the printed content materials it created, but all plates, negatives, and color separations produced. In each of these cases, the printer owned and transferred tangible and intangible property to the purchaser, because they were hired to create or produce tangible materials. In this case, Catalina performed its targeting services but had no ownership of or control over the content of the coupon message ultimately issued. If any significant aspect of the marketing service offered by Catalina involved the design of the coupon itself or coupon production, Catalina’s Performance Agreements would have contained specifications as to the appearance or production quality of the coupon.²⁹ The

²⁹ The print quality of a Checkout Coupon™ Program coupon is low resolution, single color with little or no graphics. See Granger Affidavit, Exhibits 2 through 5. Even by small volume/home printing standards, the targeted coupon is low-tech. Clearly when the targeted coupon distributed by Catalina is compared to the non-targeted coupons found in newspaper inserts, magazines etc, (typically glossy, multicolor offset printed), it is clear that Catalina is selling, and the manufacturer is buying, something much different from Catalina than a physical coupon or ad message.

fact that the design, message, and all content on the coupon or advertising message, was controlled by the manufacturer supports a finding that Catalina was providing services.

B. Catalina Merely Transmits Electronic Instructions.

As described in the Statement of Facts, Catalina performs its services electronically. Catalina's electronic computer equipment was connected to the checkout scanner: receiving information on 72.5 million shopping cart purchases each week, processing that information, analyzing it by reference to the nationwide, continuously-updated database, and then applying the results to the criteria pre-specified by each manufacturer with whom Catalina had contracted for the cycle. Then, when the result of this analysis was completed, Catalina would download computer software over the telecommunication lines supplied by the retailer instructing the computer network on how the manufacturer wanted to interact with this shopper. If the result of the marketing analysis was that the manufacturer wanted this shopper to receive a discount offer, Catalina's software would include the digitized message and a print order. The retailer would hand this message to the shopper for free. Catalina's role clearly is established as (1) a marketing consultant assisting manufacturers in targeting desired shoppers, (2) a processor of data through the custom application of computer software and (3) a distributor of an offer or message by supplying an electronic instruction to a thermal printer located at the point of sale. What Catalina is not is the seller of tangible personal property at retail in the State of Michigan.

C. Unlike the Printers in *Shelby Graphics* or *Speaker-Hines*, Catalina Did Not Contract to Produce a Tangible Product.

A comparison of the facts and circumstances of the transactions at issue in *Shelby Graphics* and *Speaker-Hines* to the transactions at issue here shows that Catalina is selling services, not manufacturing a coupon.

In *Shelby Graphics*, the company designed and furnished signs, banners and point of purchase displays. The company regularly kept a quantity of paper stock for use to produce these items on hand and was given considerable latitude in designing the end product. The MTT found that the contract was for the tangible end product created by Shelby Graphics, not merely for advertising services.

Similarly, in *Speaker-Hines*, a printing and lithography company printed manuals, publications, brochures and the like for the State of Michigan. The State provided the paper for most of the work. The MTT rejected the Department's classification of the transactions as a sale of services when the customer supplied the paper.³⁰ Instead the MTT found that the determinative issue is whether the seller owned significant tangible and intangible content which it transferred to its customer. The MTT noted that Speaker-Hines owned and introduced into the finished product "a significant quantum of both tangible and intangible content."

In this case, Catalina did not produce or transfer any tangible product. Under the Performance Agreements, the manufacturer was responsible to provide all coupon content including any intangible assets to be incorporated therein such as logos or trademarks. See SOF Exhibits A & B at ¶1.2, App 119a, 122a. The manufacturer owns all coupon content. Ownership of these intangibles never passed to Catalina. Catalina merely reduced the coupon information to digital information that was imbedded into its software program. The software program was downloaded into the Catalina computer network and caused a print order to issue when the predesignated scanning event occurred. Unlike *Speaker-Hines*, Catalina did not add

³⁰ Under *Speaker-Hines*, the fact that Catalina provided the rollstock used to print the coupons is not determinative of whether a sale at retail is present. Rather, the test under *Speaker-Hines* is whether Catalina owned tangible and intangible property which it then transferred to its manufacturer customers. This test is not met in Catalina's case.

graphics, typesetting, text modifications, bindings, inks or mats to the software. Catalina was merely electronically distributing an intangible message or coupon owned by the manufacturer. Catalina transmitted print instructions to the Checkout Coupon™ printer and the retailer distributed the coupons pursuant to the Distribution Agreement. See SOF Exhibit C, App 125a-132a. Unlike *Shelby Graphics*, Catalina did not create the content of an advertising message and did not expend considerable effort designing the tangible form. Catalina did not create any content at all or transfer anything that it owned to the manufacturer. In *Shelby Graphics* and *Speaker-Hines*, printing was part of production of the end product, whereas for Catalina printing was merely a means for distribution. These two cases are wholly inapplicable to the facts of Catalina's transactions.

Comparing Catalina's services to the transactions in *Shelby Graphics* and *Speaker-Hines* clearly demonstrates that Catalina's transactions were for marketing and distribution services, not for the production of printed coupons. In both *Shelby Graphics* and *Speaker-Hines*, the customer contracted for specific printed items: signs, banners and point-of-purchase displays in *Shelby Graphics* and printed manuals, publications, brochures in *Speaker-Hines*. The type of product to be produced varied based on the customer's needs. Under the Performance Agreements between Catalina and its manufacturer/customers, the customers contracted for exclusive distribution rights for product categories for four week cycles. The "coupon" terms in paragraph 1.2 did not vary from contract to contract. *Speaker-Hines* provided a complex four-color photographic process for printing. Printing provided under the Catalina Distribution Agreement was monochrome and low quality. [See Granger Affidavit, Exhibits 2-5, App 79a-82a]. In both *Speaker-Hines* and *Shelby Graphics*, the printers provided chip board, cover board, cloth, carbon sheets and the like. In contrast, Catalina provided no such tangible inputs and

merely distributed, by a crude printing process, the manufacturer's message/coupon offer. In both *Speaker-Hines* and *Shelby Graphics*, the printers expended considerable effort to control, design and create the finished printed product, and were responsible for the ultimate design of the product. Catalina exerted no effort on the coupon message itself, as that was provided by the manufacturer. The manufacturer was responsible for the ultimate design of the coupon. Rather, Catalina exerted considerable effort locating the targeted shopper to whom the coupon should be distributed. Thus, the Checkout Coupon™ Program transactions are nothing like the sales at issue in either *Shelby Graphics* or *Speaker-Hines*. Catalina transferred only intangible property already owned by its manufacturer customer. Catalina was performing targeted marketing distribution services, not sales at retail.

VI. There is No Sale at Retail By Catalina Because Paper is “Incidental” to the Services Sold By Catalina.

Even if the printed message or coupon is considered tangible personal property, it must be characterized as incidental to the services provided by Catalina under well established case law and the analysis of the Court below. As incidental property, the sale by Catalina to the manufacturer is correctly recognized to be entirely the sale of services³¹ and not a sale at retail.

A. “Incidental to Services” Analysis is Longstanding Case Law.

In *University of Michigan Board of Regents v Dep’t of Treasury*, 217 Mich App 665; 553 NW2d 349 (1996), the Court of Appeals applied the statutory “sales at retail” standard to

³¹ The courts below and the Department’s Brief in Opposition wrongly focus on the act of distributing the advertising message or coupon (the only part of Catalina’s transaction occurring in Michigan) as if it were the “sale” being measured as taxable or not, and to which the Department then applied the real object test, instead of the sale at retail standard. The Department misrepresented the transaction by referring to the grocery store shopper that receives the checkout message or coupon as the “consumer.” The Department not only applies the wrong standard, it also focuses on the wrong party. See, e.g., Respondent-Appellee’s Brief in

determine whether a transaction involving both the provision of services and the transfer of tangible personal property was taxable. This case addressed whether the University of Michigan (the “University”) owed sales tax on sales of (i) photocopies made by students and others at photocopy machines made available by the University at its libraries, dormitories and other places operated by the University, and (ii) replacement diplomas provided to graduates at a minimal cost of \$5 each.³² The Court of Appeals upheld the lower court’s determination that the University of Michigan had not “engaged in the business of making sales at retail” of photocopies under MCL 205.52(1) stating:

We find no error in the Court of Claims’ determination that photocopies made by students were not subject to sales tax. Fundamentally, the sales tax is a tax upon sellers for the privilege of engaging in the business of making retail sales tangible personal property. *Terco, Inc v Dep’t of Treasury*, 127 Mich App 220, 225-226; 339 NW2d 17 (1983). “Business” is defined in the sales tax act as “an activity engaged in by a person or caused to be engaged in by that person with the object of gain, benefit, or advantage, either direct or indirect.” MCL 205.51(1)(j); MSA 7.521(1)(j). The university was not in the business of selling photocopies as a retail enterprise with a profitmaking objective; the five-cent charge closely approximated the actual cost of one photocopy. Rather, the university provided an academic library, and the convenience of and charge for photocopies were an incidental part of library operations. 217 Mich App at 669. (Emphasis added,)

The Court noted that other states adopted an “incident to services” analysis for mixed transactions. Where tangible property is incidental to the provision of services, no sale of tangible property occurred. The Court of Appeals referenced a Wisconsin case holding that a law firm’s invoicing of a client for photocopies, “was not in the nature of a retailer’s ‘mercantile

Opposition to Application for Leave to Appeal, first paragraph of Introduction section at page 5 and throughout. Compare to definition of “consumer” presented in same Brief at page 8.

³² The sale of meals to non-students, *e.g.*, the attendees at summer sports camps hosted at the university’s facilities, was also addressed in the context of a specific sales tax exemption, not relevant to the matter at issue.

transaction’ but instead, was incidental to the legal services provided.” 217 Mich App at 669, quoting *Frisch, Dudek & Spattery Ltd v Wisconsin Dep’t of Revenue*, 133 Wis App 2d 444, 447-449; 396 NW2d 355 (1986). The sale at retail standard is a facts and circumstances standard that considers the transaction as a whole.³³ The incidental to services analysis in the *University of Michigan* case is recognition of the common sense reality of virtually all service transactions – that just because the transfer of some property is involved in the performance of a service, the transaction is not converted into a sale at retail, i.e., entirely the sale of property. The printed coupon or message that issues as a result of Catalina’s targeted marketing distribution services is incidental to those services.

B. The Court of Appeals Was Persuaded that Property Was Incidental to Catalina’s Sales of Services, But Wrongly Deferred to the MTT Under an Incorrect Standard of Review.

The Court of Appeals acknowledges that Catalina had persuasively argued that the paper messages and coupon offers that it prints are incidental to its services. However, the Court of Appeals deferred to the factual and legal “finding” of the MTT even though summary disposition is reviewable *de novo*, as a matter of law. COA Opinion at p 7, App 56a; *International Business Machines v Dep’t of Treasury*, 220 Mich App 83; 558 NW2d 456 (1996). Thus, the Court of Appeals’ stated its position as:

³³ This Court has recognized in other sales/use tax context the importance of considering the transaction as a whole and the purpose of the taxing scheme of the complimentary and supplementary sale and use taxes when applying the imposition language of the statutes. In *Elias Bros. Restaurant, Inc. v Dep’t of Treasury*, 452 Mich 144; 549 NW2d 837 (1996), this Court found that a taxpayer/food preparation business had purchased food for preparation and resale to its own restaurants as well as to restaurants owned by third party franchisees. Also see, *Holy Spirit Association for the Unification of World Christianity v Dep’t of Treasury*, 131 Mich App 743, 754; 347 NW2d 707 (1984) where the Court of Appeals found that the distribution of candy and flowers in solicitation of donations is not a sale at retail because the transferor/exempt organization was able to show its intent to gift the property, not sell it.

Although this Court may have reached a different conclusion, we cannot say that the Tax Tribunal committed legal error in concluding that petitioners' activities were subject to sales tax or that the decision is not supported by competent, material and substantial evidence. COA Opinion at pp 7-8, App 56a-57a.

This Court, using the appropriate standard of review, should find that any property involved in the Checkout Coupon™ Program is incidental to Catalina's services. Accordingly, Catalina is only selling services, not tangible personal property.

C. Paper Generated is Clearly Incidental to Services Provided by Catalina.

1. Nature of the Paper is Not Relevant and Cost is Negligible, Thus Proving Paper is Incidental.

Under the incidental test of *University of Michigan Board of Regents*, the printed paper utilized to distribute the ad messages or coupon offers is merely incidental to the program services. First, Catalina is selling, and each particular client is buying, as evidenced by the large base fee paid by a client, the customized data gathering and targeted marketing distribution services of Catalina. The same clients can buy non-targeted coupons from other sources³⁴ at a cost that is only a small fraction of the base fee a Catalina manufacturer must pay. Moreover, the manufacturer pays the base fee for services whether or not any coupons or ad messages are issued during its four week cycle. Therefore, the coupon or ad messages are merely incidental to the marketing services provided by Catalina, much the same as the photocopies, wills, trusts, or contracts produced by a law firm is to the provision of legal services.

Property is also incidental when it is not distinct from the service being purchased. For example, when a lawyer drafts a will for a client, the paper is merely the medium by which the service is transmitted. *Manatron v Dep't of Treasury*, 4 MTT 537 (Docket No. 84131) (1986)

³⁴ The costs of the Checkout Coupon Program far exceed the costs of coupons distributed in newspapers. See SOF Exhibit I, p 8, App 285a.

(sale of property tax forms to a local government is a service). Similarly, in the custom software cases discussed above,³⁵ the physical manifestation of a customized computer program, such as a disk, is merely a medium for transmitting the intangible property representing the digital commands that make up the computer program. Likewise, the paper coupon is merely the medium for delivery of a manufacturer's message. Catalina is selling, and its clients are buying targeted marketing services. The coupons merely transmit one possible implementation of the customized application of Catalina's system sold to a particular manufacturer to address the marketing of a specific product.³⁶

Under the Checkout Coupon™ Program, Catalina is selling targeted marketing services which result in the distribution of a targeted advertising message or coupon. The targeting services must occur each time a product is scanned, whether or not a message or coupon is issued. These services occur as a prerequisite to every message or coupon that is issued and coupons or messages are issued only a small fraction of the time the targeting services are provided. Thus, the printed coupon offer is not distinct from the targeting services being purchased by the manufacturer any more than a paper will is distinct from the legal services it represents. The printing of the ad message or coupon content, all of which is owned by the manufacturer at all times, on a small piece of paper as a medium of distribution does not convert the entire targeted marketing transaction into one in which Catalina is selling that piece of paper to the manufacturer.

³⁵ See *supra* at pp 23-26.

³⁶ Even if the coupon is arguably property, it must be considered intangible as a mere manifestation of the Catalina system having no value to the product manufacturer apart from these marketing services that identify the shopper to whom it is distributed.

Under Michigan case law, as discussed above at pp 36-39, if a transaction is properly analyzed as essentially a sale of a service, the incidental inclusion of some property, whether tangible or intangible, does not change that character and automatically cause the transaction to be analyzed and taxed as a “mixed transaction” (one that is bifurcated into a sale of a service and a sale of property). Both the statute and case law³⁷ apply the mixed transaction analysis when distinct and identifiable businesses or business transactions are carried on by the taxpayer which result in transactions with customers that are severable with a portion appropriately being subject to the sales tax. In Catalina’s case, none of these characteristics are present. It is engaged in only one business transaction – targeted marketing distribution services. No tangible property is sold to its clients. And even if there were a transfer in Michigan of tangible property to the client, there is no rational way to separate the transaction – the distribution of the print instruction to the retailer is fully integrated and not severable from the marketing and information processing services. Those services would be performed in a meaningless vacuum without the communication of the results by sending a message to print the manufacturer’s specified message or not. In the same way, the analysis of an auditor would be meaningless without the communication of the results in a piece of paper embodying the signed opinion.³⁸ The fact that the doctrine of the mixed transaction just does not apply to what Catalina does further supports the conclusion that it is wholly a service and, in the minority of cases when

³⁷ MCL 205.52(b); *Sims v Firestone Tire & Rubber Co*, 397 Mich 469, 245 NW2d 13 (1976); *Natural Aggregates Corporation v Dep’t of Treasury*, 133 Mich App 441; 350 NW2d 272 (1984), lv den 419 Mich 949 (1984).

³⁸ Cf. *Natural Aggregates*, Id. (where taxpayer sold gravel and offered delivery of such product, the customer was invoiced separately and could purchase one without the other); *Sims*, Id. (sale of tires and wheel balancing services to same customer were viewed as separate transactions); *Kal-Aero, Inc v Department of Treasury*, 123 Mich App 46; 333 NW2d 171 (1983), lv den 417 Mich 1093 (1983) (flight instruction and aircraft rental distinct and identifiable under the use tax).

Catalina's analysis results in a paper message, if that is considered tangible property, it is incidental to the dominant service transaction.

2. Function of Coupon Could be Replaced with an E-Credit to the Account of the Shopper, Which Clearly Would Not Be a Retail Sale.

The incidental nature of the paper is apparent because Catalina could perform its services under the Checkout Coupon™ Program using alternative distribution methods. In the near future the manufacturer's promise to discount its product, currently distributed by Catalina for its manufacturer/clients on the paper checkout coupons, will likely be replaced by the distribution of an entirely digital promise to discount in the form of an e-credit. A particular manufacturer's promise to discount will be stored for use against the targeted shopper's future purchases in Catalina's network of participating stores. The shopper's use of its frequent shopper card/electronic identifier, the same one used by Catalina to track shopper purchases in its data base, will notify the retailer on the system that the particular e-credit/coupon is available to reduce the shoppers next bill. In the case of the current paper coupon and the coming e-coupon, Catalina's services are exactly the same. Catalina is being compensated to identify targeted shoppers and to distribute the manufacturer's checkout coupon/message only the shoppers more likely to respond with a future purchase. Catalina is not being compensated to "produce" the coupon. Catalina is performing a distribution service only upon its identification of a particular targeted shopper using Catalina's nationwide computer hardware and software network. Catalina's targeted distribution of a manufacturer's promise to discount (or any other type of targeted marketing message for the manufacturer's product) is not the sale of tangible personal property by Catalina to the manufacturer.

3. Catalina's Activities and Contractual Obligations to Manufacturer Could Be Accomplished by An Employee Observing Behavior and Providing Advice.

The incidental nature of the paper coupon is even more starkly illustrated by considering the clear service character of Catalina's role if Catalina were also performing the same function in a low tech manner. Catalina could perform its targeted marketing distribution services using people located at retail stores instead of its network. Consider a cheese manufacturer that wants to market its product and expand its market share by offering \$1.00 off the retail price of its cheese, but only to the shoppers purchasing a competitor's brand. The manufacturer does not want to offer the dollar off to shoppers already purchasing its brand of cheese, since this would only decrease margins and do nothing for expanding market share. If Catalina were hired to manually perform its Checkout Coupon™ Program services to this marketing initiative, it would unequivocally be selling a service. Catalina could have people standing at the checkout lines to either ask shoppers if they buy the client's cheese, or a competitor's cheese, or no cheese at all. Alternatively, the Catalina employees could visually inspect the contents of the shoppers' carts as they check out, to see what kind of cheese, if any is purchased.

Once purchasers of a competitor's cheese were manually identified, Catalina's employees could instruct the retailer's cashiers to inform these shoppers that they will be entitled to \$1.00 off the client's cheese product in a future visit to the store. The shoppers could be handed instructions on how to redeem this offer. The instructions could tell them to give the Catalina employee manning the checkout lane their name and some other identifying information. Catalina employees could assemble a master list. When shoppers return and want to redeem the offer, they could identify themselves to a Catalina employee who could verify they are on the master list. If the shopper is on the list, Catalina could instruct the cashier to give the discount, and then update the master list.

The paper involved here, *i.e.*, the instructions distributed to shoppers and the master list, although tangible, do not constitute tangible property sold in the transaction between the manufacturer and Catalina. It would be similar to the shipping boxes and receipts utilized by an express delivery service, or the paper used by an attorney drafting a unique contract or will. Catalina is selling in this illustration exactly the same services it sold in the Checkout Coupon™ Program transactions at issue – targeted distribution services. The coupon is only an incidental and inconsequential medium for documenting and communicating the manufacture's intent to discount the purchase of their cheese but only for this specific and targeted shopper.

VII. Even Applying the Real Object Test, Catalina's Manufacturer/Clients are Purchasing Services.

A. Manufacturers Contract for Identification of Target Audience and Exclusive Communication Rights with Identified Shoppers.

The real object test was first applied to determine whether a transaction was a sale of services or tangible personal property by the MTT in the unappealed *Shelby Graphics* decision in 1986.³⁹ The MTT developed the real object test based completely on non-Michigan case law. In *Shelby Graphics*, the MTT stated the real object test is a “standard [that] calls upon the trier of fact to discern whether, from the perspective of the purchaser, the purpose of the transaction lies in the transfer of an end product or in the acquisition of services.”

³⁹ It is not clear that the real object test is consistent with MCL 205.51, sale at retail definition. The statute looks to the purpose of transaction as a whole analyzing the facts and circumstances in relation to the seller's business to identify taxable sales of tangible personal property. The real object test only looks at the transaction from the purchaser's point of view. However, this inconsistency is not determinative in this case, because under the real object test, Catalina's manufacturer clients are seeking to obtain services.

The Department of Treasury applied and expanded⁴⁰ the real object test by issuing RAB 95-1.⁴¹ RAB 95-1 was issued to differentiate between the sale of a service and the sale of tangible property, particularly with respect to “complex transactions” that involve elements of creative, intellectual and personal services as well as tangible personal property. The Department states the real object test as: “From the perspective of an impartial third part, what is the purchaser seeking? A tangible end product produced by a service, or merely the service itself?” The Department also provides general standards to aid in real object determinations.

Catalina’s activities are probably best analyzed under the Department’s standard for applying the real object test to intellectual services, which states “when the object of the transaction is to obtain the special intellectual ability or knowledge of the ‘seller,’ the sale will be judged to be a nontaxable service transaction.” RAB 95-1. On the other hand, the sale will be judged a sale of tangible personal property subject to tax if the main object the purchaser seeks is “to obtain the tangible manifestation of knowledge.” RAB 95-1. Under this standard, the manufacturer is clearly seeking Catalina’s special abilities. As discussed above at pp 23-26, Catalina provides a unique service that is not available from anyone else. The indiscriminate printing and issuance of coupons to all shoppers in a retail store would violate the Performance

⁴⁰ RAB 95-1 was not promulgated in accordance with the Administration Procedures Act and has no precedential value because it is merely the Department's interpretation of the law. MCL 205.3(f). *See also* Footnote 17. Catalina asserts this does not have any practical importance in this case because the proper application of the RAB 95-1 real object test would result in Catalina’s activities in Michigan being classified as nontaxable services.

⁴¹ The Department’s real object test fundamentally applies an all or nothing testing where the entire cost of services in a mixed transaction is attributed entirely to the property transferred in the same transaction. This position is taken in spite of the clear rejection of the very same concept by this Court years before the MTT (*Shelby Graphics, supra*) and the Department (RAB 1995-1) attempted to legislate the real object standard as an irreconcilable replacement for the statutory sales tax imposition standard of “sales at retail.” *See, Sims v Firestone Tire & Rubber*

Agreements. The object of the transaction is to obtain the special intellectual ability or knowledge of Catalina and for shoppers to receive coupons, advertising messages, or nothing.

As discussed throughout, the delivery of a printed coupon offer is not necessary for the manufacturer to obtain value from its contractual relationship with Catalina; the manufacturer more accurately is seeking from Catalina information on what incentives to give to which shoppers. Manufacturers could, and often do, obtain coupons from coupon printing companies at a much lower cost than they pay for Catalina's target marketing services. Furthermore, the manufacturer is not seeking to obtain the coupon from Catalina since at no time did Catalina own or control the coupon. The manufacturer already owned and supplied all coupon information. Catalina was just the distributor. Moreover, the targeted checkout coupon or ad message does not change hands between Catalina and the manufacturer; it belongs to the manufacturer and is given *gratis* to shoppers at retail outlets. It is the information on the coupon/message, "Buy our product" or the redemption promise that manufacturers wish to convey to specifically-targeted customer groups. Finally, the complete absence of any coupon design specifications in the contract itself clearly shows that the manufacturer was far more interested in the requirements for Catalina to provide its strategic target marketing services than anything related to the paper coupon.

B. RAB 95-1 Examples Show that the Real Object is Services

The Department's own analysis in RAB 95-1 (App 402a) of how to identify a taxable sale of tangible personal property transaction versus a service transaction support finding services as the real object of the Checkout Coupon™ Program.

Stores, 397 Mich 469; 245 NW2d 13 (1976) (a single transaction involving the taxable sale of tires and the non-taxable sale of tire rotation services).

In Example 3 (App 403a), the Department admits that when an attorney is hired to draft a person's will and produces a written document expressing those wishes; the transaction is entirely the sale by the attorney of nontaxable services. The tangible property transferred, the written will document is deemed to be, "only an inconsequential element of the transaction." RAB 95-1 at 5, App 406a. So, too, are the printed coupon offers at issue here. The Court of Appeals noted that Catalina had persuasively argued that these printed coupon offers are "merely an inconsequential medium with which to transmit information to specifically-targeted customer groups" Court of Appeals at 7, App 56a.

In contrast, Example 4 (App 403a) shows how a written will document could be a tangible piece of property the sale of which would be taxable. Example 4 involves a packaged set of preprinted will documents and instructions. The Department explains the difference compared to Example 3 as: "Intellectual expertise of an individualized or customized nature has not been purchased." The coupons and messages at issue here clearly result from the type of application of individualized knowledge and intellectual content that makes the will in Example 3 a nontaxable service and not the will in Example 4, which is property sold at retail. Moreover, the manufacturer is also seeking and obtaining specialized knowledge of when not to issue a message or coupon.

In Example 7 (App 407a), RAB 95-1 addresses XYZ, a marketing company hired to formulate a product evaluation questionnaire for ABC's blender. XYZ is also hired to mail the questionnaire, and to receive and process the results to develop a customer profile. This scenario is very analogous to Catalina's Checkout Coupon™ program. Catalina is hired by manufacturers to gather and process information. Just like the Department concluded that ABC did not seek to obtain the questionnaires, but rather the information provided in response to the questionnaires,

the Department should have concluded that Catalina's clients did not seek to obtain a stack of coupons, but rather the information gathering and data analysis behind the targeted distribution technology. The only difference in these two scenarios is that ABC gets information from the distribution. Manufacturers get information from Catalina prior to distribution and based on that information limit their message and coupon distribution. The manufacturer did not seek to obtain the coupon from Catalina. After all, the content of the coupon was supplied by the manufacturer to Catalina. Because the manufacturer sought to acquire the identification of potential product purchasers and the targeted distribution of the coupons/messages to shoppers more likely to act on the message/coupon, under the real object test, Catalina is selling entirely services with an inconsequential medium used to transmit information.

The service character of the Checkout Coupon™ Program is further illustrated by RAB 95-1, Example 8 (App 407a). The same manufacturer, ABC seeks marketer XYZ's expertise in obtaining, analyzing and compiling product information on the same blender. XYZ prints a product evaluation questionnaire for the blender which XYZ, "under a separate contract," also mails to registered blender purchasers. The Department identifies two distinct transactions: the taxable sale of preprinted stock questionnaire forms and the nontaxable distribution service. As applied to Catalina, Example 8 indicates that even if the transaction were separated into two, both aspects still would be nontaxable: (1) the intellectual service of identifying specific shoppers and providing information on their buying habits with the purpose of leading to an informed communication opportunity for the manufacturer with respect to that shopper and (2) the distribution service of electronically transmitting the coupon and print order for the targeted shopper and handing it to him or her gratis under contract with the retailer. Additionally, a comparison of the printer contracts in *Shelby Graphics* and *Speaker-Hines* to Catalina's

transactions further supports the conclusion that the manufacturer was contracting for Catalina's services. See *supra* at pp 31-36.

In summary, under the Department's own RAB examples, Catalina's manufacturer clients do not seek to obtain the slip of paper which represents the coupon or ad message itself, but instead seek to obtain services sold by Catalina. The printed coupon offers and messages distributed by Catalina represented "an inconsequential medium used to transmit the information sought." The manufacturers with whom Catalina contracted relied on Catalina's marketing expertise to enhance sales of their products through sophisticated targeted marketing programs designed to foster future purchases of the manufacturers' products. To this end, the manufacturer is seeking Catalina's expertise in identifying whether shoppers should receive or not receive coupons or messages. Therefore, even under the Department's real object test, the manufacturer is not purchasing the printed coupon but rather is purchasing the specialized targeting services and distribution services.

CONCLUSION

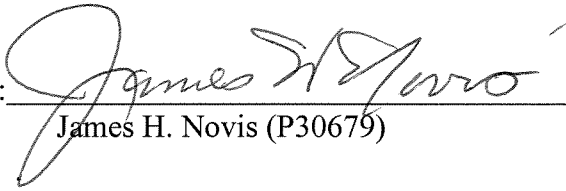
Catalina's Checkout Coupon™ Program is a sale of services under any analysis provided by statutory or judicial law. This Court should hold that sales of the Checkout Coupon™ Program are not sales at retail.

Respectfully submitted,

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Dated: June 10, 2003

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